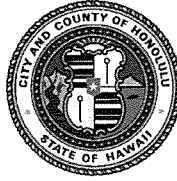


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DEPUTY MANAGING DIRECTOR

May 13, 2013

The Honorable Ann H. Kobayashi, Chair
and Members of the Budget Committee
Honolulu City Council
530 South King Street, Room 202
Honolulu, Hawaii 96813

Dear Chair Kobayashi and Councilmembers:

SUBJECT: Collective Bargaining Pay and Benefit Increases for FY2014

In a recent council meeting, you asked the Administration how we intend to cover the collective bargaining pay and benefit increases for FY2014. Our detailed response is below, but in summary, without enhancements to revenue, services will need to be prioritized and existing funds may need to be reallocated.

The Mayor proposed a fiscally responsible, balanced budget that focused on core services. The budget included an increase in fuel tax revenues that are needed to cover the rising costs of expenses related to roads, bus service, and other highway-related expenses, including debt service for bonds issued to pay for road rehabilitation.

The Administration's plan was to cover collective bargaining costs within the budget. Funding for vacant positions was included as part of each department's budget, and directors were expected to manage all of their operational costs, including collective bargaining increases, within their budgets. This would allow departments the flexibility to manage their operations because they know best what they need to provide services effectively. However, in the event that the collective bargaining costs were determined to be too much for the agencies to reasonably cover within their budgets, the plan was to request that Council move funds from certain centralized provisional accounts to the Provision for Salary Adjustments account to help pay for the collective bargaining costs.

The City Council amended the budget to move vacant position funds from the agencies budgets to citywide provisional accounts. It is our understanding that the fifty percent cut to the vacant position provisional in CD1 will be restored and moved to the salary adjustment provisional account.

Our calculations show that about \$24.3 million remain in the Provision for Vacant Positions account and that approximately \$25.6 million is available to be added to the Provision for Salary Adjustment account. The monies in these accounts will be needed to cover the cost of filling positions, paying for police and fire recruits, lump sum vacation payouts and collective bargaining costs.

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Collective bargaining costs have been a moving target as negotiations have been completed. Initially, we estimated \$20 million based on 3% increases. As events unfolded, we increased that estimate to \$26 million. Our current estimate is approximately \$37.5 million. In addition, we will need at least \$5 million to pay for lump sum vacation pay for employees leaving the City during the year. To cover these costs you could tap into centralized provisional accounts such as the Provision for Other Post-Employment Benefits (OPEB) and the Reserve for Fiscal Stability Fund. However, be aware that the City needs to fund OPEB to meet its obligations to provide health benefits for retirees, and needs to set aside reserve funding in case of emergencies. In addition, bond raters consider the funding of these accounts as a measure of the City's financial stability, therefore decreased funding could affect the City's bond rating.

We continue to urge that you reduce the approximately \$10 million in grants in aid funded by general funds that were added to the budget. These amounts are in addition to the Charter created Grants in Aid Fund that already takes \$5.5 million of general funds off the top. The Charter provides a process for selecting grantees for the Grants in Aid Fund and provides for the level of funding. The additional \$10 million in grants earmarked for specific organizations is outside of this process, and is a significant increase in cost to the General Fund. The revenues needed to fund these grants equates to an increase of eight cents in the real property tax rate of \$3.50 per \$1,000 of assessed value for homeowners. This would be, on average, an increase of \$48 per homeowner per year.

In response to your question on how the Administration will replace the revenues from the fuel tax that Council rejected on first reading, we are willing to work with the Council to discuss other revenue raising measures. However, at this point of the budget process, the responsibility to pass out a balanced budget rests with the Council. Section 3-112 of the Revised Charter on the City and County of Honolulu (Charter) states,

"The council, at the meeting at which the annual legislative and executive budget ordinances are enacted, shall also enact such measures as will yield sufficient moneys, together with available surplus and other available moneys, to balance the budget."

Additional revenues are needed to make the budget sustainable, for this year and future years. Expenses will increase – collective bargaining costs will be compounded in future years and other costs such as debt service, OPEB, retirement, and health insurance will increase sharply as well. Relying on cuts alone to balance the budget this year will reduce services in FY 2014, and will create the need for a much larger revenue increase in FY 2015. In addition, the bond raters consider the City's willingness to raise revenues when necessary as one of the primary factors in the City's bond rating.

The City Council made the decision to reject an increase in the fuel tax. The legislative branch now has the responsibility to offer an alternative to balance the budget. At this late date, an increase in the real property tax and/or bus fare increases may be the only options. We can provide you with information on revenues to assist in these decisions, in order to work towards a sustainable, fiscally responsible budget that provides funding for necessary city services.

Very truly yours,



Ember Lee Shinn
Managing Director